Supreme Court of the United States.

October Term, 1940.

No. 506

A. B. & M. Liquidation Corporation,
Petitioner,
v.
Pelham Hall Company et al.,
Respondents.

A. B. & M. Liquidation Corporation,
Petitioner,
v.
Myles Standish Company et al.,
Respondents.

Petition for a Writ of Certiorari to the Circuit Court of Appeals for the First Circuit
and
Brief in Support Thereof.

RICHARD WAIT,
CHARLES P. CURTIS, JR.,
Counsel for Petitioner.

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TABLE OF AUTHORITIES CITED.

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MYLES STANDISH COMPANY et al., respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

To the Honourable the Justices of the Supreme Court of the United States:

The undersigned, on behalf of the above-named petitioner, pray that a writ of certiorari may issue to review the judgment of the Circuit Court of Appeals for the First Circuit entered June 7, 1940, in the cases between the above-mentioned parties docketed therein as No. 3542 and No. 3543.

Opinions Below.

The opinion of the District Court is published in 28 F. Supp. 350. The opinion of the Circuit Court of Appeals is published at 112 F. (2d) 498. No opinion was announced on the denial of the petition for rehearing.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered June 7, 1940 (Rec. p. 115). A petition for rehearing was filed in the Circuit Court of Appeals on June 21, 1940, and was denied on July 15, 1940 (Rec. p. 116).

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended.

The actions to which the petition relates are bills in equity (commenced in 1937 under the old practice) in which the petitioner as holder of bonds and coupons secured by a trust mortgage seeks to share in the security and to force the issuance to it of securities in the reorganized corporations pursuant to the provisions of reorganization plans. The jurisdiction of the United States District Court where the bills were originally brought was based upon diversity of citizenship under Section 41(1) of the Judicial Code, as amended.

Statement.

From 1904 until its bankruptcy in 1931 the American Bond & Mortgage Company was engaged in the business of marketing and dealing in real estate securities.

In 1925 it was proposed to construct an apartment house in Brookline (Pelham Hall) and an apartment hotel in Boston (the Myles Standish). Two wholly distinct Massachusetts corporations, The Pelham Hall Inc. and The Myles Standish Inc., were then formed to construct and run the buildings. The funds necessary for the projects were to come from issues of bonds secured in each instance by mortgage of the property. Except for the proceeds of the sale of these bonds neither corporation had any material resources. Until the buildings were erected and tenanted there could be no source of income from which to pay either the interest or the principal (Rec. p. 48).

The bonds were to be marketed by American Bond & Mortgage Company. In each instance they were coupon bonds, bearing 6½% interest, payable semi-annually, and had serial maturities—the first two years after the date of issue. They were specifically labelled "Construction Bonds" in large red printing on their face.

Pursuant to these plans mortgage indentures (identical for all present purposes) were executed. The Myles Standish indenture was dated June 1, 1925. It provided for the issue of $1,450,000 of bonds and mortgaged the property to Harold A. Moore as individual trustee to secure the bonds and coupons (Rec. p. 44). The Pelham indenture was dated September 1, 1925. It mortgaged to the same trustee. The Pelham issue was $1,200,000 (Rec. p. 39).

The bonds were payable both as to principal and interest at the office of the American Bond & Mortgage Company in Chicago or New York, and American Bond & Mortgage Company was the paying agent of the issuer in each instance (Rec. pp. 39, 44). The funds from which it would discharge the obligation of the issuer on the first two coupons would come from moneys retained from the proceeds of sale. Thereafter the issuer was to make monthly payments of one-sixth of the interest next to fall due to American Bond & Mortgage Company. Similar payments were to be made to meet serial maturities of principal.

There was no promise by American Bond & Mortgage Company to make any payments whatsoever on behalf of the issuer out of its own funds. But although under no obligation, it was given the right to make payments by which any defaults by the issuer could be financed. This right was to purchase bonds and coupons and to hold them as outstanding (and consequently fully secured) obligations of the issuer whenever the issuer failed to make the payment due upon those bonds and coupons. This provision is

found in article II, section 3, of each indenture, which read:

> "If at any time the Company [issuer] or its assigns shall fail to pay any bond or coupon secured hereby as and when the same falls due, then American Bond & Mortgage Co., Inc. or any person, firm or corporation (when not acting for said company) may purchase and hold the same, and such bond or coupon shall not be subordinated to other outstanding bonds and coupons but shall be considered as past due obligations of the company for all purposes" (Rec. pp. 40, 41).

There was likewise a saving clause to the same effect in section 2 immediately preceding.

As things fell out each issuer did "fail to pay . . . [each] bond or coupon secured hereby as and when the same falls due." When the third coupon became due, Pelham Hall Inc. had made no payments to the American Bond & Mortgage Company. Consequently, that company exercised its option and purchased with its own funds those coupons which were presented at its offices, and the same procedure was followed on both issues with reference to each subsequent coupon maturity through December 1, 1928, in the case of the Myles Standish, and through March 1, 1929, in the case of Pelham Hall (Rec. pp. 16, 17, 79, 80).

On the early principal maturities nothing was paid by either issuer, and American Bond & Mortgage Company purchased all of the serial maturities due June 1, 1927, December 1, 1927, and June 1, 1928, of the Myles Standish Company. In the Pelham case it purchased all of the bonds maturing September 1, 1928, and March 1, 1929.

No specific notice was given by American Bond & Mortgage Company to holders of the bonds who presented coupons that it had not been put in funds by the issuer and that

it was purchasing the coupons for its own account under the provisions of the indentures. In the case of the maturing bonds which were purchased, a document known as a resale authority was sent in each instance to the party who presented the bond. The terms of these documents do not appear in the record. A large number of them were introduced in evidence in the District Court, but they were not designated by the appellants to be part of the record. They were not certified as a part nor transmitted to the Circuit Court of Appeals as separate physical exhibits with certain others. The trial judge found with reference to them:

> "The course of dealing with the bonds paid by the Mortgage Co. out of its own funds was this:
>
> "When the bond was presented for payment, the Mortgage Co. gave to the customer a 're-sale authority' or a 'customer re-sale order'. If the bonds were presented by a bank, acting for the owner or transmitted by mail, the 'authority' or 'order' was sent to the party presenting or transmitting the bond, who may or may not have been the owner. Some of these re-sale orders were signed by customers and copies retained by the Mortgage Co., but so many of them had been lost or destroyed that it was not possible to determine how many were signed by the actual owner of the bond. Without awaiting a re-sale the Mortgage Co. paid the amount of the bond, and no separate account was set up with the customer presenting the bond, or coupon, except as a matter of statistical record" (Rec. p. 49).

He also stated in his opinion:

> "All that I have said above relative to coupons is equally applicable to the matured bonds acquired by the Mortgage Co. The additional fact that the Mortgage Co., in each case, took a re-sale order from the

customer, clearly indicating an intention to purchase, is significant. These orders were notice to the customers of this intention. It is objected that the notice was not given until the bonds were received by the Mortgage Co. The bonds were not registered bonds, and it is difficult to see how the intentions of the Mortgage Co. could have been communicated to the holder until the bonds were presented for payment. In some instances the re-sale orders were signed by the holders themselves, and in others they were mailed to the party forwarding the bond. In the latter case, notice to the agent would be notice to the bondholder'' (Rec. p. 54).

As a result of all these transactions, American Bond & Mortgage Company held Myles Standish coupons amounting to $171,007.52, Myles Standish bonds amounting to $61,900 (Rec. p. 80), Pelham Hall coupons amounting to $114,255.72 and Pelham Hall bonds amounting to $30,900 (Rec. pp. 17, 18). In acquiring these it had expended its own funds and not a cent had come from the issuer in either case.

After December 1, 1928, in the Myles Standish case, and after March 1, 1929, in the Pelham Hall case, American Bond & Mortgage Company did not exercise its right to purchase the bonds and coupons, the subsequent defaults were not financed, and the properties went to foreclosure.

The Myles Standish mortgage was foreclosed May 15, 1929, and the trustee bid it in at the foreclosure sale on a bid of $1,622,391.31, which constituted the entire amount due on all bonds, coupons and other obligations secured by the mortgage, including the bonds and coupons held by American Bond & Mortgage Company. Eventually a reorganization plan was set up and made effective under which

bondholders would receive voting trust certificates of the new corporation in the proportion of one voting trust certificate for each $100 face of obligation.

In the Pelham Hall case the reorganization was put through in immediate connection with the foreclosure. The property was bought in by the straw of the reorganization committee on a bid of $450,000. The plan provided for the issuance of voting trust certificates representing one share of stock in the new corporation for each $10 face of obligation for those bondholders who had deposited their bonds.

Voting trust certificates were issued pursuant to these plans to all depositing bondholders save American Bond & Mortgage Company. As to its bonds and coupons claim was made that, although neither issuer had paid a penny toward their discharge, American Bond & Mortgage Company had paid them rather than purchased them and consequently that they could not share in the security, and the question was left to be determined by litigation.

Meanwhile American Bond & Mortgage Company itself became involved in the bad times and went into bankruptcy. The petitioner was formed as a medium for the liquidation of certain of the slow assets of the bankrupt estate for the benefit of the creditors. The Pelham and Myles Standish bonds and coupons passed to it and it commenced these suits to force the issuance to it of the voting trust certificates to which it, as holder of the bonds and coupons, was entitled under the plans. The controversy consequently was between two classes of creditors (Rec. p. 39).

The cases were heard together by Judge Brewster in the District Court. He ruled that the provisions in article II in the identures were inserted in order to allow the Mortgage Company to purchase just as it did; that those provisions were binding upon the bondholders, and that the Mortgage Company was within its rights in acting under them. He further ruled that notice to each bondholder that

it was doing so was unnecessary since otherwise the provisions would be mere surplusage, but pointed out that notice was given in the case of the bonds although not in that of the coupons (see Rec. pp. 52-55). He consequently ordered the entry of decrees in the plaintiff's favour.

The defendants other than Boston Safe Deposit & Trust Company and the interveners appealed.

The Circuit Court of Appeals for the First Circuit reversed the decree of the District Court and held that none of the bonds or coupons of either company taken up by the American Bond & Mortgage Company at or after maturity should be permitted to share in the reorganization proceedings on a parity with bonds and coupons not so taken up. The Circuit Court was of the opinion that the American Bond & Mortgage Company was under an obligation to give notice of its intention to take up matured bonds and coupons and hold them and that nothing in the provisions of the indentures freed it from this obligation. In the case of the coupons, the Circuit Court found no such notice whatsoever. In the case of the bonds, as to which the District Judge had held that the resale authorities gave constructive notice, the Circuit Court both denied the effect of the resale authorities as constructive notice and in any event held that constructive notice, even if given, was not sufficient.

The Circuit Court of Appeals sometime after the briefs had been presented and the oral argument had been completed secured from the District Court Clerk's office for its inspection the resale authorities which had been introduced in evidence in the District Court but had not been made a part of the record before the Circuit Court. The court considered the resale authorities and commented upon their terms as "somewhat vague and technical" in its opinion (Rec. p. 114). The petitioner was given no opportunity to present argument before that tribunal as to the interpretation and legal effect of these instruments.

Upon the rendition of the opinion of the Circuit Court, the petitioner filed a petition for a rehearing before that court, which petition was denied (Rec. p. 116).

Questions Presented.

Three questions are presented with respect to each case:

(1) Where securities are issued under a trust mortgage which provides that, if the issuer fails to pay any of the securities, the paying agent may purchase the same, which shall not be subordinated to other outstanding securities, and the paying agent in good faith in reliance upon that provision takes up such securities with its own money and with intent to purchase, does the fact that the paying agent in so doing fails to give notice to the holders from whom such securities are taken up that it is purchasing them require equity to treat the transaction with respect to those securities as a payment with consequent forfeiture of the money expended by the paying agent in taking them up?

(2) If on the facts stated in the preceding question failure to give the notice there referred to results in equity in forfeiture of the money advanced by the paying agent, does sending a statement indicating an intention to purchase satisfy the requirement of notice?

(3) Is it permissible for a Circuit Court of Appeals, on the basis of inspection of exhibits introduced in the District Court but not certified to the Circuit Court as a part of the record on appeal, to reverse and modify a finding by the District Judge to the effect that the statements referred to in question (2) above constituted notice?

Specification of Errors.

The Circuit Court of Appeals erred—

(1) In not giving proper effect to the decision in *Ketchum* v. *Duncan*, 96 U.S. 659.

(2) In holding that American Bond & Mortgage Company was required to give notice to bond and coupon holders that the securities which it acquired from them were being purchased and not paid, before it could be entitled to secure parity for such securities in the reorganization proceedings.

(3) In holding that the sending of a statement to bondholders, indicating an intention to purchase, did not satisfy this requirement of notice, assuming such a requirement existed.

(4) In basing its decision with respect to the parity of the bonds held by the petitioner upon the resale blanks, which did not form a part of the record on appeal and as to the interpretation and legal effect of which the petitioner was afforded no opportunity for argument.

(5) In reversing the decree of the District Court which granted the petitioner the right to have voting trust certificates of Myles Standish Company and Pelham Hall Company issued to it on a parity with all other holders of bonds and coupons.

Reasons for Granting the Writ.

1. The Circuit Court of Appeals departed from the accepted and usual course of judicial proceedings in reversing the decree of the District Court in so far as it dealt with recovery based upon bonds picked up at or after maturity through a construction of documents introduced in evidence before the District Court but not certified as a part of the record on appeal.

The record on appeal was made up strictly in accordance with the provisions of Rule 75 of the Rules of Civil Procedure. The resale authorities, so called, which the Circuit Court of Appeals construed as insufficient to constitute notice to the bondholders but which the District Court had held to constitute notice, were not included in that record. It is provided by Rule 75 with reference to the record:

> "The matter so certified and transmitted constitutes the record on appeal."

The Circuit Court of Appeals reversed the ruling made by the District Judge with reference to the resale authorities following an inspection of the original exhibits made after the conclusion of arguments without amendment of the record, without any prior notice to the petitioners, and further denied the petitioner's motion for rehearing based upon this action of the court.

Orderly procedure in the courts requires that there be no question as to the matters open to inquiry by an appellate court. It is important that this Court should determine whether a party before a Circuit Court of Appeals must anticipate decision of the appeal on the basis of material introduced before the District Court but not certified or transmitted to the Circuit Court of Appeals and consequently, within the provisions of Rule 75, not a part of the record on appeal.

2. The Circuit Court of Appeals decided an important question in the law of corporate securities in a manner which does not give the proper effect to the position of this Court in the case of *Ketchum* v. *Duncan, supra,* which is in apparent conflict with the decision of the Fifth Circuit Court of Appeals in the case of *Anderson* v. *Pennsylvania Hotel Co.,* 56 F. (2d.) 980, and which leaves the question of

the effect to be given to such applicable state court cases as *Lyman* v. *Stevens,* 123 Conn. 591, and *Chicago Title & Trust Co.* v. *Hoffberg,* 293 Ill. App. 290, completely unanswered.

It is of great importance to dealers in corporate securities acting in good faith pursuant to the provisions of an indenture governing the rights in the security to know with as much certainty as possible how far, if at all, the general law imposes additional requirements not set forth in the indenture. Substantial certainty with reference to the existence or non-existence of a requirement of notice not provided for in an indenture when a paying agent follows the common practice of picking up maturing bonds and coupons can be attained only through the decision of this Court. Until there is an authoritative decision to be followed in all circuits settling whether additional requirements will be read into the indentures, and if so, what requirements, the confusion presently existing must continue.

3. The result of the decision of the Circuit Court of Appeals is to cause the petitioner to be subjected to a forfeiture. The petitioner's predecessor had advanced its own money in order to purchase securities from certain of the bondholders and thereby enabled those bondholders to secure the face value of their securities. The petitioner is now denied the right to share in the mortgage security even at the reduced rate provided for in the plan of reorganization. This forfeiture has been enforced without any showing of prejudice to any bondholders and upon a record from which it is apparent that the bondholders benefited from the transaction. The creditors of the American Bond & Mortgage Company who would be the beneficiaries of any recovery by the petitioner in this action are in effect being compelled to donate some $325,000 to the other Myles Standish and Pelham Hall bond and coupon holders, a result which scarcely recommends itself to a court of equity.

Wherefore it is respectfully submitted that this petition shall be granted.

RICHARD WAIT,
CHARLES P. CURTIS, JR.,
Attorneys for the Petitioner.

CASSELS, POTTER & BENTLEY,
Of Counsel.

COMMONWEALTH OF MASSACHUSETTS
SUFFOLK } ss.

Richard Wait, being duly sworn, says that he is counsel for A. B. & M. Liquidation Corporation, the petitioner herein, that he prepared the foregoing petition, and that the allegations thereof are true as he verily believes.

RICHARD WAIT.

Sworn to and subscribed before me this eleventh day of October A.D. 1940.

SIMON P. TOWNSEND,
Notary Public.